Faculty Working Papers

A REINTERPRETATION OF GERMANY'S NEW PLAN OF 1934

Larry Neal

#245

College of Commerce and Business Administration
University of Illinois at Urbana-Champaign

FACULTY WORKING PAPERS

College of Commerce and Business Administration

University of Illinois at Urbana-Champaign

May 8, 1975

A REINTERPRETATION OF GERMANY'S NEW PLAN OF 1934

Larry Neal

#245

A Reinterpretation of Germany's New Plan of 1934

by

Larry Neal

Associate Professor of Economics
University of Illinois
at Urbana-Champaign

In September 1934, Dr. Hjalmar Horace Greeley Schacht, President of the Reichsbank and Minister of Finance under Adolph Hitler, brought into operation his New Plan for Germany's foreign trade. The New Plan centralized trade into 25 supervisory centers which would allocate the available foreign exchange for sanctioned import transactions. Trade agreements were concluded with a number of countries -- especially in Central Europe and South America -- where German purchases abroad were credited for offset purchases in the German markets. By Spring of 1938 "such offset account agreements operated in no fewer than twenty-five countries, so that more than half Germany's foreign trade was carried on through these channels." (26, pp. 302-3).

Hailed by Schacht and many German writers as a significant innovation and advance in the conduct of foreign trade, the New Plan has been described only in varying degrees of opprobrium by economic historians. Bluntest is the assessment by Gustav Stolper (27, p. 143).

> Schacht's New Plan cut Hitler's economy loose from international customs and manners. For decades the expression "schachtianism" was used in the English-speaking world to characterize a policy of tricks, discrimination, and the ruthless pursuit of egotistical aims in world trade. The traditional methods of world trade....were now replaced in German trade policy by bilateral arrangements.

Why should bilateral agreements be identified with "tricks, discrimination, and the ruthless pursuit of egotistical aims" at least any more so than the "traditional methods of world trade"? The major reason appears to be the relative size of the economies of Germany and her clearing agreement partners. The importance of the German market to the exporters in Central

Europe and Latin America, and the eventual importance of German imports to the economies of these countries meant that Germany had an apparent bargaining advantage in the negotiations setting up the terms of each clearing, or barter, agreement.* However, there are historical difficulties with this line of argument. Germany began its negotiations at a relative disadvantage compared with the previous great trading partners of these countries -- the United States, Great Britain, or France. Condemnation of Schacht and his methods is unfair if not balanced by similar condemnation of the other large trading nations for not constraining the bargaining ploys of Schacht to their advantage and the advantage of the small trading nations. There are difficulties with the economic aspects of the argument as well. The economic advantages which can in theory be gained by a superior bargaining position in bilateral exchange were in fact never realized by Germany.

A reinterpretation of Schacht's New Plan appears to be needed. The interpretation offered here will be that the clearing agreements conferred political rather than economic advantages upon Germany; and that Germany purchased these political advantagesby conferring the larger part of the gains of trade upon her trading partners. The key to the success of these agreements -- political for Germany, economic for her trading partner -- was the role played by the central banks in each country. In sum, there existed a trade-off between the political goals and the economic advantages which were possible from either side. To finance the exchange of political influence for economic advantage, novel uses were made of the new central banks created after World War I -- uses which spawned techniques still in use today in international finance.

I. The Economics of the New Plan

If economic advantage were the German goal in negotiations of clearing agreements with smaller countries, there were basically only two ways they could be accomplished: 1) the exercise of <u>monopsony power</u> by forcing the small trading partner to accept lower than competitive prices on its products imported by Germany, or 2) using <u>monopoly power</u> to force the small country to pay higher than competitive prices on the German exports it purchased. The first technique appears to be what one textbook suggests was used when it states, "as Germany soon discovered, a lack of balance in its trade with other exchange control countries provided a means whereby it could take advantage of its buyer's position to exploit countries largely dependent on Germany for their export market." (13, p. 213).

The difficulty with this suggestion is that the prices offered by Germany to its trading partners for its imported commodities were consistently above the world price and the internal price within the partner country. The foreign foodstuffs it purchased from Southeastern European countries were bought at prices from 20 to 40 percent above the world market price (11, p. 157). Basch cites the case of Germany paying prices for Roumania's soybeans that were several times those charged overseas (2, p. 218). Further, Germany on average paid more for the same commodity when it was imported from a clearing agreement country than when it was imported from a non-clearing country. It may be argued, of course, with Guillebaud (11, p. 151) that these high prices were merely for the sake of entrapment, and that renewal of the clearing agreements would bring a

substantial reduction in these prices. Indeed, it is true that German officials were dissatisfied with the exchange rate of the mark in exchange markets and attempted to improve it in order to lower the cost of imports while attempting to revise clearing agreements on more favorable terms. This was not accomplished with any success, however, until 1942 after Germany had absorbed nearly all of Central Europe into the Third Reich (2, P. 219).

Granting the failure of Germany to act in a manner befitting a monopsonist, the argument can still be made that the high prices it paid for imports were not high compared to German domestic prices while the prices of German exports were high compared to world prices. This is to say that if Germany did not exploit its relative size by exercising power as a monopsonist, this was done to enable it to exercise power as a monopolist on the export side. Guillebaud, in fact makes this argument asserting that "in large compensation transactions, Germany is often able to secure a price for her exports which is well above the ordinary competitive price" (11, p. 158, fn. 2). "Since Germany maintained an overvalued mark throughout the period of exchange control, the exercise of monopoly power on the pricing of exports was necessary to avoid either a deficit on trade account or a significant reduction in the volume of trade."

This argument is explicitly rejected by Howard Ellis who examines in particular the German export drive after 1934 to the southeast. His description of the prototype case of Yugoslavia is especially revealing.

> In order to give the German buying drive momentum, German export goods had been offered at low prices during the first year or two. But when German purchases had raised even the level of domestic prices in Yugoslavia, and when the limit of full employment began to be felt in Germany, the prices of export goods began to rise, not only overtly but also covertly in the deterioration of quality and in long delays in delivery. To offset these effects, (my italics) German purchasing agencies offered to sell at incredibly generous "terms" with almost negligible down payments (10, p. 264).

The rise in German export prices after a year or two was not due to the practice of monopoly pricing by German trade authorities, but due to the effects of inflation on the general price levels in Germany and Yugoslavia. Instead of exploiting this situation to German advantage, German authorities tried their best to offset these forces towards higher prices, purposefully avoiding the gains possible from monopoly pricing. The Yugoslavia example helps explain why the terms of trade continued to move against Germany throughout the operation of the New Plan from 1934 to 1938. From 1935 to 1936 import prices rose by 3.8 percent while export prices fell by 2.9 percent. From 1936 to 1937 import prices rose by 10.2 percent while export prices only rose 3.6 percent (11, p. 100, 149). The situation became even worse when the war broke out. Ellis comments that "the monopsonistic position which Germany had created for herself by clever exploitation of clearing agreements led to her having a monopoly in significant segments of her partner's market." (10, p. 264). But it appears that Germany made a considerable investment over a number of years to achieve a monopoly position she never utilized.

Ellis' argument is that Germany willingly paid higher than

competitive prices for imports from clearing agreement partners and sold her exports at less than competitive prices to establish a growing political power "which could scarcely fail to menace the economic status of Southeastern Europe generally (10, p. 265). Table I below shows the percentage share of both imports and exports which Germany enjoyed in Southeastern Europe both before and after the New Plan.

Table I. Germany's Percentage Share in the Trade of Southeastern Europe

(I = imports, E = exports)

	1929		1930		1931		1932		1933		1934		1935		1936		1937	
	I	E	I	E	I	E	I	E	I	E	I	E	I	E	I	E	I	E
Bulgaria	22	30	23	36	23	30	26	26	38	36	41	43	54	48	61	48	55	43
Greece	9	23	10	23	12	14	10	15	10	18	15	23	19	30	22	36	27	31
Hungary	20	12	21	10	24	13	22	15	20	11	18	22	23	24	26	23	26	24
Yugoslavia	16	9	18	12	19	11	18	11	13	14	14	15	16	19	27	24	32	22
Roumania	24	28	25	19	29	11	24	12	19	11	16	17	24	17	36	18	29	19

Source: League of Nations, International Trade Statistics (Geneva, 1938)

It is clear that Germany did increase her share of the trade in Southeastern Europe but it is also clear that her trade was already substantial before the Depression. Indeed, since Germany had carried on a substantial part of her foreign trade with eastern and southeastern Europe before World War I, the provisions of the various peace treaties of 1918 which divided these areas into a large number of small countries actually set the stage for the exercise of economic power by Germany (12, p. 94). Further, the revival of international trade during the "five good years"[2] of 1924-28 saw a substantial rise in Germany's share of the foreign trade of the new

cessionary and succession states. During the depression this share fell in general, so that the rising shares under the New Plan may represent to a large extent the effects of restoring prosperity to the economies concerned.

While Ellis agrees that the economic effects of the clearing agreements cannot be separated from the effects of domestic recovery he does argue on theoretical grounds that they created economic losses for both Germany and the partner nations. The economic losses were not from the exercise of monopoly power by Germany, but from the resource misallocation which was the result of Germany's drive to build up a monopoly position. This process is epitomized, in Ellis' view, by the diversion of Germany's cotton imports from the United States to Brazil, which previously had produced very little cotton and almost none for export. This meant that Germany was receiving cotton from a high-cost producer while Brazil was losing the export proceeds which could be obtained from other export crops (10, p. 252). This argument is valid, but only if the implicit economic assumptions of the argument were validated by the economic conditions of the 1930s. These are, at a minimum, that the partner nation be at full employment (otherwise, the resources Brazil put into cotton production would have zero opportunity cost) and that the previous allocation of resources was optimal. Given the dangers of monoculture for an underdeveloped nation and the frequent use of Brazil's reliance upon coffee as an example of these dangers, the latter assumption may be questioned.[3] Certainly, all countries relying upon the export of primary products for earning foreign exchange had large reserves of unutilized reserves coming

out of the depression in 1933. Even as late as 1938, League of Nations studies found that Latin America was making substantial increases in the production of cocoa, tobacco, cotton, wheat, meatpacking, wood products, fuels and power, metals, and non-metallic minerals. Only in coffee was the level of production falling from 1936 to 1938. (14, pp. 173-181). On the German side, reviving trade with lowest cost producers would have required giving up the advantages of the moratorium on transfer of foreign exchange to service the huge foreign debt of Germany -- the largest of any nation before the depression. Ellis therefore overstates the real costs both to Germany and her partner countries of the clearing agreements. Indeed, the only basis he suggests for using the resource misallocation argument is the fact that the total volume of Germany's foreign trade recovered to pre-Depression levels -- which could be a tribute to the efficacy of the New Plan rather than a criticism of its efficiency.

II. The Finances of the New Plan

If Germany did not actually exploit the potential economic advantages of a monopsonist or monopolist position, and if the economic advantages of competitive pricing were foregone with little real cost to either Germany or Germany's partners, innovative financial arrangements were required. The key arrangements were but a few ot the welter of innovations and regulatory interventions made by the German officials responsible for administering the New Plan. The effectiveness of the financial arrangements is measured by the fact that so many of the other regulations were designed to oppose their effective operation.

The government regulators of the New Plan probably did not know

what they were doing that was working so well in the field of foreign trade. Officials tried to reduce the prices paid on imports and made constant efforts to improve the terms of trade; fortunately they were doomed to failure by the maintenance of an overvalued mark which meant deficits would be incurred with respect to trade with countries where trading agreements were not in effect. To carry out trade without running a deficit, it was necessary for German exporters and importers to make private compensation agreements. German importers needed to find exporters who could provide them with foreign exchange claims so they could get permission to import. The exporter's price, due to the overvalued mark, was x percent over the world price. The importer would pay him this premium of x percent in marks, the exporter would make the foreign sale, but sell the foreign exchange gained to the importer. The import would be made, the domestic price jacked up by x percent to recover the premium, and all private parties to the transactions in Germany and abroad, were content without a capital outflow from Germany.

This process was greatly facilitated by the development of ASKI marks (acronym for Ausländer Sonderkonten für Inlandszahlung) which would be received in the first instance by an exporter of goods to Germany (who charged more than he would have for payment in regular marks). He could sell these, at a discount, to the importer of goods from Germany who then used them to pay the German price (11, pp. 68-70). The mark remained overvalued, but the ASKI mark effectively floated. This was in effect a two-tier exchange rate, so highly favored by France and Belgium today, since Germany made payments on her huge foreign indebtedness in gold marks*,

---

* A provision put in Dawes plan by E. W. Kemmerer

but made payments on merchandise accounts in ASKI marks.

More important for the states of southeastern Europe were the clearing agreements. Since German exports to these states were expensive and limited to non-essential goods permitted to leave the country while German imports from the states were substantial and priced about 30% above the world price, export surpluses were built up in the partner nations. In Southeastern Europe, Germany was accumulating large debts amounting to Rm. 450 million in 1934 and to Rm. 367 million in March 1935 (2, p. 175). The exporters in the countries of southeastern Europe who had accumulated these claims tried to sell them in their own countries. In each case it was necessary for the Central Bank to intervene if the blocked marks (Sperrmarks) were not to depreciate relative to the gold mark or relative to the exchange rate fixed upon in the original clearing agreement with Germany. Bulgaria was the only country in which the rate remained unchanged from the original parity; in Hungary a premium was added to the mark for trade in certain commodities by agreement between the National Banks; in Roumania the National Bank's initial refusal to support the price of clearing marks in the open market was overcome by German pressure in future commercial negotiations; Yugoslavia exercised considerable independence letting the clearing marks fall to 12.5 dinars when the official rate was 17.5; the Bank of Greece maintained the official rate by steady intervention (2, pp. 176-7). Export surpluses by the countries involved were being sustained by capital exports to Germany in the blocked accounts. On the basis of foreign credits held by the Central Bank in the subjugated country, domestic note issues could be made. The effects of domestic

monetary expansion under the depressed conditions prevailing was upon employment rather than prices.

The expansionary effects of central bank activities in the partner nations were strongest when the bank supported the German Sperrmarks which were earned by its exporters; weakest when the Sperrmarks were allowed to depreciate. So Hungary and Bulgaria benefited most in economic terms from the clearing agreements, while politically these two countries were most favorable to German influence. Roumania and Yugoslavia, on the other hand, refused to accept the economic benefits possible from increased German trade, motivated by their lingering hopes for the success of the Petite Entente or some regional economic bloc in the Danubian basin which would exclude Germany (cf. 2, chs. 9, 17). Indeed, the National Bank of Roumania was plagued by a Foreign Advisor (French) who recommended as late as 1935 that 85 of the 115 banks in Bucharest should be eliminated and that 430 out of 924 banks in the provinces should disappear (25, p. 109). Roumania was able to have a substantial budget surplus in 1935-6 while Bulgaria maintained an expansionary deficit.

The willingness of the central banks in Hungary, Austria, and Bulgaria to accept the blocked marks in effect as foreign exchange reserves to be used for note issue can be explained in part by their previous experience with the gold-exchange standard in the late 1920s. In fact, the financial arrangements which underlay the success of the clearing agreements from the viewpoints of both partners can be seen as the culmination of the interwar experiments with financial reconstruction of the new European nation states. Experiments which began with the League of Nations supervised

reconstruction loan to Austria.

III. <u>The Historical Background to Schacht's New Plan</u>

The financial situation of the new nations of central and eastern Europe was one of the worst trouble spots of the world depression from 1929 to 1933. Indeed, their financial woes were the proximate source of the collapse of the world monetary system which occurred in 1931 after the failure of the <u>Kreditanstalt</u>. Their situation can be analyzed very simply -- falling world prices for their main export commodities enabled them to earn less foreign exchange to pay the service charges on their foreign debt which were fixed in nominal terms. Table II reproduces the pertinent information from the report of the League of Nations Stresa Conference dealing with the problem.

Table II. <u>The Transfer Problem of Central and Eastern European Nation-States</u>

(All figures in millions of Swiss francs (=$0.19 on old parity)

Country	Year	Trade surplus (+) or deficit (-)	Total foreign debt (1932)	Foreign debt service charges	
Austria	1929	-782		110	
	1930	-622		110	public debt
	1931	-622		135	only
Jan.-June	1932	-209	2,432	214	all foreign debt
					(moratorium on June 23, 1932)
Hungary	1929	-25		177	
	1930	+50		255	
	1931	+16		248	
Jan.-June	1932	-16	3,774	---	(moratorium)

(Table cont'd.)

Table II. (cont'd.)

Country	Year	Trade surplus (+) or deficit (-)	Total Foreign debt (1932)	Foreign debt service charges
Bulgaria	1929	-69		24
	1930	+60		31
	1931	+47		30
Jan.-June	1932	-9	715	15 (15 in moratorium
Czechoslovakia	1929	+78		51
	1930	+276		86
	1931	+213		70
Jan.-June	1932	-36	2,037	52
Poland	1929	-176		113
	1930	+108		145
	1931	+242		152
Jan.-June	1932	+62	4,457	NA
Romania	1929	-14		
	1930	+170		165 public debt
	1931	+192		172 only
Jan.-June	1932	+63	5,266	194
Yugoslavia	1929	+25		
	1930	-15		
	1931	0		
Jan.-June	1932	+6	3,269	116

Source: League of Nations, Report by the Stresa Conference for the Economic Restoration of Central and Eastern Europe (Geneva, 1932), Annex 3.

By the time of the Stresa Conference, those countries benefiting from League supervision in the early twenties had suspended transfer payments on short term credits and long term loans, and had instituted exchange controls through their central banks. These banks had been closely tied to the Bank of England, which was now off the gold standard. The members of the Petite Entente had not suspended payments on foreign debt although exchange controls were being introduced with respect to the currencies of

the succession states, as a defensive measure. Their central banks were more closely affiliated with the Bank of France, still on the gold standard. Oddly enough, the export surpluses of the Petite Entente and Poland [also on the gold standard] continued into the first years of the world depression, in each case because falling exports were offset by falling imports. It appears from closer analysis that the decline in imports was achieved mostly at the expense of neighboring states, by reducing the imports of foodstuffs and raw materials (2, pp. 37-40). Hungary, with the largest debt service, would normally be expected to have the largest export surplus but it was hurt first by a commercial war with Czechoslovakia starting in 1930 and then by a restriction of agricultural imports by Germany.

By 1931, the service of the external debt ranged from 16% of total exports in Bulgaria to 48% in Hungary. (Czechoslovakia, the most industrialized country of the region with relatively little external debt compared to internal debt had only 5% of its exports accounted for by debt service) (15, p. 7). Here was the classic dilemma confronting the Bank of France in its allegiance to the Gold Standard -- attaining full partnership in the key currency club meant undermining the debt service mechanism used to exercise political control in the debtor countries. Indeed, by 1929 it was becoming apparent in the felicitous phrase of the League's World Economic Survey, 1931/32 "Capital was flowing uphill from the debtor to the creditor countries" (p. 177). With this reverse flow of capital, the means of political control were being eroded as private investors sought their own economic interests.

Why had France undermined the debt service mechanism in the new

states by its return to the gold standard? A major part of the explanation is illustrated in Table III.

Table III. Distribution of World Gold Stocks 1924-34

(millions of dollars)

Country	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934
United States	4090	3985	4083	3977	3746	3900	4225	4051	4045	4865	5980
England	748	695	729	737	748	710	718	588	583	928	973
France	710	711	711	954	1253	1633	2100	2699	3254	3022	3216
Germany	181	288	436	444	650	544	528	234	192	92	19
Italy	221	222	224	242	266	273	279	296	307	373	306
Total	8956	8974	9210	9568	10028	10306	10917	11291	11897	11942	12858

Source: Charles O. Hardy, Is There Enough Gold? (Washington, D. C.: Brookings 1936), pp. 92-93.

From holding 8 percent of the world's monetary stock in 1924-1926, France increased its holdings to 19 percent under the regime of Émile Moreau and topped out at 27 percent under Clément Moret in 1932. It was argued by the Gold Delegation (greatly encouraged by Norman) that this scramble for gold by the major gold exchange standard countries had caused an excess demand for gold, given the needs and abilities of the United States and Great Britain to maintain their stocks. The counterpart of this excess demand for gold was, of course, an excess supply of goods offered in international trade. Given the effectiveness of American and British techniques for sterilizing gold stocks, compensating gold flows did not occur. Given stabilized currencies (42 countries were on the gold exchange standard at the end of 1928), there was no nominal price adjustment in the gold market. The full price effect of the international disequilibrium came in the commodity markets. Prices there began to tumble in 1928 and the pent-up

deflation of the mid-twenties (staved off by producers' cartels and internal price support programs) dropped prices very rapidly as the financing of various price support schemes collapsed. This, in turn, meant a reduction in the nominal export earnings of the exporters of primary goods while their foreign debt service remained fixed.

The chief architect of France's return to the gold standard was Emile Moreau, appointed Governor of the Bank of France on June 24, 1926. It was the peculiar circumstances of the stabilization of the "franc Poincaré" combined with the personal animosity of Moreau and Montagu Norman, Governor of the Bank of England, that led directly to the collapse of the gold exchange standard in 1931. The outcome of Moreau's resolve to return to a fixed exchange rate combined with the fact that the rate determined on was 10 percent below the current purchasing power parity, gave the Bank of France immense holdings of sterling claims even by Spring 1927. Moreau began to put pressure upon the Bank of England by asking for gold in exchange for some of his sterling holdings. His nominal excuse was that this was necessary in order to cut off credit in the London money market for speculators on the French franc anticipating that the final rate would be at the purchasing power parity.

In addition to this limited goal (which could have been done more quickly and more effectively by domestic measures Moreau was fully capable of implementing himself), Moreau wished to establish himself as a full and equal partner in the "Central Bankers Club" along with Norman, Strong, and Schacht. And, as he wrote, "in a more general way, try to adjust French and English interests on the question of interallied debts and the working of the Dawes Plan with a promise to examine together European monetary questions." (20,

p. 324). Prior to his historic confrontation with Norman on May 27, 1927, (see below) Moreau had explained to Poincaré to what purposes he intended to exercise his power over the Bank of England.

> "I propose to profit from our situation which is temporarily very strong, by concluding an agreement with the Bank of England to defend our respective currencies against speculation. M. Poincaré counseled prudence because the financial situation of England had deteriorated badly for some time...I continued my statement by telling the President that we could try to get support from Norman in Europe, notably for the issue of the Dawes securities. M. Poincaré replied that he doesn't want for the moment more than a partial placement of the obligation, because we would have to evacuate the Rhineland if the total issue was placed...On the other hand, he counsels me to work at gaining major influence among the Petitie Entente, which through hatred of England and fear of Germany, are now entirely with us." (20, pp. 319-20).

Finally, Poincaré instructed Moreau to do nothing to offend the United States!

Moreau made every effort to carry out Poincaré's political instructions while discomforting Norman and his chief aides in whom he found "no frankness, but a hypocritical attitude, based on malevolence but tempered fortunately by fear." (Moreau, p. 545). His chief work with respect to East Central Europe was the stabilization of the Roumanian leu, which he sought to carry out independently of the League of Nations and of Norman. ("M. Quesnay asks us if we have the intention of keeping Norman outside the consortium. Naturally yes." (20, p. 496)) To do this, he sent experts from the Bank of France to the Bank of Roumania to study the situation at first hand and to draw up a plan of stabilization to be submitted in the first instance to Benjamin Strong for his approval. The plan had to observe the League's principles, however, to be acceptable to Strong.

Moreau explained to M. Kiriacesco, Governor of the Bank of Roumania, that "concessions on the part of the Bank of Roumania will be, on the other hand, necessary to strengthen the independence of the Bank vis-a-vis political parties and to assure foreign control over the Bank." (italics added) (20, p. 510).

Fortunately for Moreau's case with Strong, Norman had not gone to the Financial Commission for one of his most important stabilizations, that of Italy's lira in 1927. Moreover, neither the Bank of France nor any other European central bank was asked to participate in the negotiations, only in the loan. Similarly, the stabilization of the Belgian belga and the Polish zloty had taken place by going to Strong directly without going through the League's Financial Commission. These precedents helped Moreau justify to Strong his circumvention of the League and Norman.*

Norman had begun his efforts at reconstruction loans and currency stabilization in Austria in 1922. His attention was drawn quite naturally to Austria through the difficulties of two Austrian banks, the Anglo-Austrian and the Laender Bank. In 1914, at the outbreak of hostilities, the Bank of

---

* Moreau carried his case to Strong so effectively that on March 23, 1928 Strong felt compelled to send a cable to Lubbock, Deputy Governor of the Bank of England, with a copy to Moreau, which concluded, "We now see no logical or consistent reason for our declining to so recommend (participation by other central banks) and at the same time we see definite advantages for harmonious cooperation by our extending to the Bank of France exactly the same support for a plan under their leadership that they and other Banks of Issue have given under the leadership of other central banks." (Chandler, p. 412). The same day, Strong sent another telegram to Lubbock (without a copy to Moreau) which concluded, "We wish to be certain that you and Norman realize (a) that we are not a bit embarrassed (b) that we are rooting for a central bank cooperation and (c) that we still love you." (6, p. 413).

England had accepted liability for acceptances by the London offices of these two banks, among many other foreign and colonial banks. The postwar difficulties of these two banks were due in large part to the loss of their branches, especially those in Czechoslovakia, with the break-up of the Austrian Empire. Since French capital was also interested in the Laender Bank, Norman focused on the Anglo-Austrian. It was decided after investigation of the bank's affairs that it should be reorganized as an English bank. The bank of England would give it a loan of working capital, accepting deferred stock in place of the 1914 acceptances. Even with this reorganization and infusion of fresh capital,the Anglo-Austrian could not be expected to resume business profitably unless it could have its war-time assets and pre-war assets released in some manner to provide security for new credits. The Austro-Hungarian Bank, the pre-war central bank it would normally turn to for support, was not functioning. The French and Italians had reparation claims, the Americans had relief credit claims, and no agreement could be reached on their proper adjudication. (8, ch. 4).

Montagu Norman worked successfully to have the Financial Committee of the League of Nations, dominated by Englishmen -- Sir Henry Strakosch, Sir Otto Niemeyer, and Sir (later Lord) Arthur Salter -- become the international agency needed. The Financial Committee became the organizing center of the entire program of reconstruction required in East Central Europe. Norman's use of the Financial Commission to handle the political problems of reconstruction combined with his use of the Bank of England to handle the international financial problems of reorganization of Austria's domestic finances set thepattern of his participation.

The reconstruction of Austria carried out by the Financial Commission followed courses of action recommended first in the Brussels International Financial Conference of 1920 and the Genoa Conference of 1922. The Brussels Conference recommended that loans be made to the countries with deteriorating exchange rates by countries having favorable exchange movements and trade balances, but that this credit should be limited to the minimum necessary, and secured by the best collateral obtainable in the borrower country. These loans should have first priority above all other indebtedness (including reparations claims by the French, and claims on relief credit by the Americans) and special security should be put aside. In the case of Germany and the new States, it was explicitly suggested that the special security be the gross charges on imports and exports. In these countries, the rapid rates of domestic inflation, the even more rapid deterioration of their foreign exchange rates meant that indirect taxes, and especially customs duties, had greatly increased in relative importance as sources of revenue for the State (League of Nations, International Financial Conference at Brussels, Geneva, 1920).

The Genoa Proposals recommended that new banks of issue be established with constitutional guarantees of their independence from the State as well as provincial and local governments. In addition, it was recommended that these new banks of issue use foreign currency or commercial bills denominated in foreign currency as a substitute for gold or silver backing of their note issue -- a gold exchange standard with, it was anticipated, sterling restored as the key currency. All these proposals and the actions of the Financial Commission based upon them appeared as sound, enlightened financial policy to Norman and to the international banking fraternity which he was now

trying to organize into some kind of cohesive, forceful group.

> [Norman] recognized that reparations, debts and reconstruction were all political questions, and that he in his field could do nothing until government, directly or through the League, had removed the political complications in the way; but this condition satisfied, they were all economic questions and should be treated as such, the marketability of a loan, on which he had to pronounce, being the test of respect for economic considerations. ...The dependence in the last resort of the succession of schemes on the issue of loans for voluntary subscription in the world's markets was an advantage; it compelled the submission of every scheme to the hard test of the market. (8, pp. 191-93).

Quite a different interpretation of the gold exchange standard roles of the Financial Commission and of the Bank of England in east and central Europe were given by Émile Moreau. Describing the reconstruction schemes of the English to Raymond Poincaré in February 1928, Moreau explained that,

> "England, having been the first European country to reestablish a stable and secure money after the war, has used that advantage to establish a basis for putting Europe under a veritable financial domination. The financial committee at Geneva has been the instrument of that policy. The method consists of forcing every country in monetary difficulty to subject itself to the Committee at Generva, which the British control. The remedies prescribed always involve the installing in the central bank of a foreign supervisor who is British or designated by the Bank of England, and the deposit of part of the gold stock of the Bank of Issue at the Bank of England, which serves both to support the pound and to strengthen British influence. To guarantee against possible failure they are careful to secure the cooperation of the Federal Reserve Bank of New York. In addition, they pass on to America the task of making some of the foreign loans if they seem too heavy, always retaining the political advantages of these operations.
>
> England is thus completely or partly entrenched in Austria, Hungary, Belgium, Norway and Italy. She is entrenching herself in Greece and Portugal. She is searching for a foothold in Yugoslavia and she is craftily fighting us in Roumania. Are we going to let this continue"? (20, p. 488).

The evidence on the actual operation of the reconstruction projects of the League in Austria and Hungary confirms Moreau's evaluation rather than Clay's. This may not be too surprising since Moreau was basing his interpretation upon long conversations with one of his chief aides, Pierre Quesnay, who had worked for four years on the Austrian reconstruction for the League. Barely three weeks after he became Governor of the Bank of France in 1926, Moreau learned of the "secret intentions of the governor of the Bank of England; M. Montagu Norman would seem to have imperialist designs upon all the European central banks." (20, p. 24). Later, Moreau sent Quesnay to visit the Bank of England to learn the mechanics of Norman's "imperialism." Evidence of Norman's domineering begins with the act of appointing the President of the Austrian National Bank. In spite of making the new central bank formally independent of the government, somehow the Geneva agreements had left it up to the Austrian government to decide who should be the President of the Bank. A. R. Zimmerman, the Commissioner-General for the League, strongly recommended to Rudolf Seipel, President of Austria, that he appoint a foreigner to the position, one who knew the money markets abroad and who would inspire confidence among overseas investors. Instead, Seipel and the Austrian Parliament, amid a great deal of public discussion, appointed an Austrian -- Dr. A. J. Reisch. As a gesture to Zimmerman, who after all had first claim on all customs receipts and the revenue of the tobacco monopoly, the two largest sources of government revenue, Seipel proposed appointing a Foreign Adviser to the Bank and nominated the Chairman of the League's Financial Committee, M. Albert Janssen, a director of the Bank of Belgium. After several months, during which the office of Foreign Adviser was formally written into the Bank's charter, a Swiss banker, M. Schnyder von Wartensee,

took the post.

All this was being done on the basis that otherwise foreign investors necessary for the success of the reconstruction loans would be wary of the Austrian debt issue. Two loans were required, one a short term loan totaling ₤3,500,000 to finance the needs of the Austrian government while it began reforms, not the least of which was to reduce employees by 100,000 over a period of two years, the other a long term loan which could be used to secure credits at the central bank. Five governments guaranteed the first loan -- equal parts by England, France, Italy, and Czechoslovakia, and a nominal 2.0% by Belgium. Over half the loan was actually raised, however, in London, with Paris raising only one-seventh, and Switzerland, Brussels, and Stockholm proportionately less. Five months later, the long term loan was floated after much careful preparation. Again, the lion's share was raised in London -- $51,660,000 -- but this time New York was allowed to participate with the next largest share -- $22,500,000. The total raised in these two financial centers plus Paris, Rome, Vienna, and Prague was a bit under $125 million. The loan was described in League documents as very successful. The meager U.S. share was oversubscribed several times within fifteen minutes of its issue, the London share three times over in two hours, and rapid oversubscription also took place in Amsterdam and Stockholm. Either Norman had done his work very well, or perhaps he had over-represented the reluctance of investors to purchase Austrian debt when it was so well guaranteed by League control over the country's finances. In his monthly Commissioner's Report, Zimmerman commented, "Such an occurrence [the rapid subscriptions] had never been

contemplated. It is evident that the Austrian State's credit, strengthened as it was by the Geneva protocols, had actually been underestimated." (Sixth Report, p. 4).

In the case of Hungary, Norman felt stronger measures had to be taken. He blocked the first League scheme for Hungary because it provided for the payment of reparations charges required under the Treaty of Trianon. The office of Foreign Adviser was written into the charter of the Hungarian National Bank from the beginning and the Adviser was given right of suspensive veto of actions of the Bank until he could consult with the Commissioner-General and the Financial Commission of the League. Not only the customs and the tobacco monopoly were to be taken as security of the reconstruction loan, but also the net proceeds of the salt monopoly and the sugar tax. Without waiting for guarantees to be put up by Allied governments, the Bank of England made a large loan directly to the Hungarian National Bank. Later, the interest on this loan as well as the interest on the Bank of England's holding of the Austrian loan were remitted to the Hungarian and Austrian banks to finance their pension plans for employees (8, p. 69). The period of negotiations was sped up and possibilities of political interference from the French reduced by eliminating government guarantees altogether. Again, the results of these preparations made to calm the nervous fears of timid overseas investors proved very satisfying with rapid subscription of the separate issues save strangely enough, the London issue where the Bank of England finally had to step in and take half the £8 million issue itself. At the end of July the price of the Hungarian bonds fell sharply in London on the basis of a rumor, apparently false, that the Americans could not

place the part of the Hungarian tranche which they had assumed (N.Y. Times, July 26, 1924). It is not odd that London, with the largest issues of these loans, should begin having difficulties with them. It is odd, however, that Norman would continue retaining the largest shares for London unless Moreau's interpretation of his motives is correct.

How successful was Norman's version of the gold exchange standard in establishing English influence in the Continent? One criterion would be to see how his efforts at central bank cooperation with respect to the new States kept them on a gold-exchange standard without having them try to go to a full gold standard. Clearly the purpose of Norman's policies from the viewpoint of gold standard enthusiasts (which includes all central bankers then and most today) was to economize on the use of gold in making international settlements. The problem was severe after World War I because of the large sums of foreign indebtedness and of reparation claims on the one hand and the virtual sterilization of the major portion of the world's gold stock by the United States, on the other. Judged in terms of this goal, Norman was brilliantly successful, at least up to the point when Great Britain had to go off the gold standard herself. Examining the reserves of the countries where Moreau felt that England had entrenched herself or was in the process of entrenching herself, we find that in 1927 and 1928 the percentages of their total international reserves which were foreign exchange holdings was quite high, both with regard to pre-war holdings and with respect to the norm of 43-48% which seemed to be established for all gold exchange standard countries in the period 1925-30. (4, p. 744). Even later, when the percentages begin to decline, the reason in each case is because total international

Table IV. Foreign exchange as percentage of total foreign exchange plus monetary gold holdings in East Central European central banks.

	1924	1925	1926	1927	1928	1929	1930	1931	1932 (Sept.)
Austria	97.8	97.4	92.3	88.5	78.8	77.2	77.0	40.3	21.0
Hungary	83.1	85.5	59.5	51.4	31.8	32.7	29.3	18.6	10.2
Bulgaria	48.1	31.7	36.2	46.7	67.5	45.3	35.7	14.9	9.5
Greece	74.4	70.0	70.5	69.7	87.0	79.5	83.2	55.0	40.3
Belgium	9.9	9.9	41.9	42.2	38.5	32.9	41.4	37.9	--
Italy	7.9	20.6	34.2	62.5	54.4	49.8	44.9	27.8	19.5

Source: W.A. Brown, The International Gold Standard Reinterpreted, 1914-1934, New York: NBER, 1940, v. II, p. 742-3.

assets of the gold exchange countries were declining as international trade declined and they settled their deficits inforeign exchange holdings in preference to giving up monetary gold.

Another criterion might be to see how English trade was increased with these countries where Norman was exercising his central bank imperialism. According to the records on trade compiled by the League of Nations, the U.K.'s percentage of total imports into Austria was actually lower by half during the mid-1920's than it was in 1913 (when it was only 6.4%), for Hungary it rose slightly reaching the unimpressive total of 3.3% in 1927, and the highest percentage of trade among the Danubian states for the British was reached in Yugoslavia -- 10.6% in 1924. The striking thing which appears among the Danubian states in the prosperous period from 1924 through 1928 is the steady rise in the relative importance of Germany toward its pre-war eminence in the foreign trade of the region. (16). Norman's grand scheme was successful viewed from the Germano-phobic perspective of Moreau, but it depended upon a rising share of British exports in the German market to make it effective from the British point of view. This

weak link in the chain of British influence over central and eastern Europe was preventing political successes for Britain from following Norman's economic successes.

IV. Conclusion

In the international monetary history of the interwar period, the conflict between the goals of foreign economic policy and of foreign political policy are best explored in the context of "central bank cooperation." This paper has focused upon the policies of the central bankers of the major powers with respect to the nascent nation states synthesized by the Paris peace treaties from the dismembered Austro-Hungarian, Ottoman, and Russian empires. These new nation-states formed the interwar analogue to the new nation-states created after World War II from the dismantled British and French overseas empires. Their monetary history is especially interesting since it shows that international economic cooperation among the major countries is not only hindered by conflicts of domestic economic policy but also by competing foreign policy aims. It was these conflicts in the sphere of foreign policy which laid the basis for the failure of the gold-exchange standard based on the United States dollar and the United Kingdom pound sterling. The French technique for restoring the gold standard proved to be unviable on economic grounds; the British technique unviable on political grounds.

While all this is relatively well-known and accepted, it has generally been overlooked that one major country did find a way to reconcile successfully its domestic economic policies with its foreign political goals, especially with respect to the new nation states of central and

southern Europe. And it has been forgotten that this reconciliation was accomplished while expanding the international trade and division of labor which are the goals of international economic cooperation. The reason this highly instructive historical experience has been ignored is because the country was Hitler's Germany, operating under the New Plan of Hjalmar Schacht, and it has implicitly been assumed that Schacht's New Plan is linked as inextricably in its economic logic with Hitler's megalomaniac impulses as it was in historical fact. In fact, the economic logic of Schacht's innovation was much more closely linked with "central bank cooperation" than with Hitler's war preparations, which were costly, risky, and promised no more economic benefits than the Neuplan was already generating for Germany.

LIST OF REFERENCES:

1. BANDERA, VLADIMIR, Foreign Capital as an Instrument of National Economic Policy, The Hague: Martinus Nijhoff, 1964.

2. BASCH, ANTONIN, The Danubian Basin and the German Economic Sphere, New York: Columbia University Press, 1943.

3. BENNETT, EDWARD W., Germany and the Diplomacy of the Financial Crises, 1931, Cambridge: Harvard University Press, 1962.

4. BROWN, W. A., The International Gold Standard Reinterpreted, 1914-1934, New York: NBER, 1940.

5. BOYLE, ANDREW, Montagu Norman, New York: Weybright and Talley, 1967.

6. CHANDLER, LESTER V., Benjamin Strong, Central Banker, Washington, D. C.: Brookings, 1958.

7. CLARKE, STEPHEN V. O., Central Bank Cooperation: 1924-1931, New York: Federal Reserve Bank of New York, 1967.

8. CLAY, HENRY, Lord Norman, London Macmillan, 1957.

9. EINZIG, PAUL, Montagu Norman, A Study in Financial Statemanship, London: Kegan Paul, 1932.

10. ELLIS, HOWARD S., Exchange Control in Central Europe, Cambridge: Harvard University Press, 1941.

11. GUILLEBAUD, C. W., The Economic Recovery of Germany, London: Macmillan, 1939.

12. HIRSCHMAN, ALBERT O., National Power and the Structure of Foreign Trade, Berkeley, University of California Press, 1945.

13. KENWOOD, A. G. AND A. L. LOUGHEED, The Growth of the International Economy, 1820-1960, London: George Allen & Unwin, 1971.

14. LEAGUE OF NATIONS, Europe's Trade, Geneva, 1941.

15. ________________, Commission of Enquiry for European Union, Report by the Stresa Conference for the Economic Restoration of Central and Eastern Europe, Geneva, 1932.

16. ________________, Memorandum on International Trade and Balance of Payments, 1913-27. Geneva, 1928.

17. ________________, World Economic Survey, 1939/41 Geneva, 1941.

18. LINDERT, PETER H., Key Currencies and Gold, 1900-1913, Princeton: Princeton Studies in International Finance No. 24, 1969.

19. LEWIS, W. A., Economic Survey, 1913-1939, London: Allen & Unwin, 1949.

20. MOREAU, ÉMILE, Souvenirs d'un Gouverneur de la Banque de France, Paris: Librairie de Medicis, 1954.

21. MUHLEN, NORBERT, Hitler's Magician: Schacht, The Life and Loans of Dr. Hjalmar Schacht, London: George Routledge, 1938.

22. PALYI, MELCHIOR, The Twilight of Gold, 1914-1936, Chicago: Henry Regnery, 1972.

23. PASVOLSKY, LEO, Economic Nationalism of the Danubian States, New York: Macmillan, 1928.

24. PETROV, VLADIMIR, Money and Conquest, Baltimore: John Hopkins Press, 1967.

25. ROYAL INSTITUTE OF INTERNATIONAL AFFAIRS, The Balkan States, vol. I, Economic, London: Oxford University Press, 1936.

26. SCHACHT, HJALMAR HORACE GREELEY, Confessions of the "Old Wizard", Boston: Houghton Mifflin, 1956.

27. Stolper, Gustav, The German Economy; 1870 to the Present, New York: Harcourt, Brace & World, 1967.

28. UNITED NATIONS, International Capital Movements During the Inter-War Period, Lake Success: 1949.

Footnotes

[1] The author gratefully acknowledges the careful reading and helpful comments made by Professor Donald L. Kemmerer, University of Illinois, and Professors René Alltmont, and Lawrence Weiser, University of Wisconsin-Stevens Point.

[2] W. A. Lewis' phrase in Economic Survey, 1919-1939. London, 1949.

[3] In 1963-5, Brazil was the fifth largest producer of cotton lint, accounting for six percent of world production, more than either Mexico or Egypt. Further, it consumed one-half of this in domestic production of yarn. [Oxford Economic Atlas, 4th edn., 1972, p. 32.]